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Cases, Regulations, and Statutes

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The taxpayer argued that the excess of liabilities over basis (which totaled $510,690) should not be subject to income tax because the transferors remained personally liable on the debt obligations.[10] The Tax Court pointed out that it has consistently held that debt in excess of basis was subject to tax on the gain involved even if the transferors remained personally liable on the debt obligations.[11] The taxpayers relied on *Lessinger v. Commissioner*[12] (where the difference between the basis of property and debt was recorded as a loan receivable from the taxpayer to the corporation) and *Peracchi v. Commissioner*[13] (the difference between the basis of assets and the liabilities transferred was recorded as a personal note from the taxpayers to the corporation). IRS, in response, took the position that the structure of the transactions in *Lessinger* and *Peracchi* was different from the way the transfer was handled in *Seggerman Farms, Inc.* in that the taxpayers in *Seggerman* did not contribute loan receivables or personal notes to the corporation to cover the difference between the transferred liabilities and the basis of the transferred property.[14] The Tax Court agreed with the distinction urged by the Service.[15] The court cited a Seventh Circuit Court of Appeals case, *Testor v. Commissioner*,[16] which denied relief to a taxpayer with a gain on incorporation where indebtedness exceeded the basis. The case of *Seggerman Farms, Inc.*[17] is appealable to the Seventh Circuit.

Recent legislation

In 1999, Congress enacted changes to I.R.C. § 357(c), effective for transactions after October 18, 1998.[18] The amendment struck the words "plus the amount of liabilities to which the property is subject" from the statute and provided relief for taxpayers transferring assets subject to liabilities where the transferor remains personally liable on the debt but for which the corporation did not assume liability.[19] The 1999 amendment also added I.R.C. § 357(d)(1)(A) which provides guidance in determining the amount of liabilities assumed and states that "a recourse liability (or portion thereof) shall be treated as having been assumed if…the transferee has agreed to, and is expected to, satisfy such liability (or portion), whether or not the transferor is relieved of such liability."[20]

The Tax Court pointed out that the 1999 amendment did not apply in the *Seggerman* case because the transaction was in 1993.[21] In dictum, the court stated that even after the 1999 amendments, "…Congress has refrained from providing relief to taxpayers in petitioners' situation,"[22] apparently in the belief that the debt obligations were assumed by the corporation.

In conclusion

It is clear that great care is needed in handling exchanges of property any time the indebtedness exceeds the income tax basis. The stakes can be high.

FOOTNOTES

1 See generally, 7 Harl, *Agricultural Law*, Ch. 53 (2001); Harl, *Agricultural Law Manual* § 7.02[2][c] (2001).
2 7 Harl, *Agricultural Law* § 53.06 (2001); Harl, *Agricultural Law Manual* § 7.02[2][c][ii] (2000).
3 T.C. Memo. 2001-99.
4 *Id.*
5 I.R.C. §§ 351, 358.
6 I.R.C. § 351(b), 358(a)(1)(A).
7 I.R.C. § 358(d).
8 *Id.* See Owen v. Comm'r, 881 F.2d 832 (9th Cir. 1989).
9 Rev. Rul. 68-55, 1968-1 C.B. 140.
10 Seggerman Farms, Inc. v. Comm'r, T.C. Memo. 2001-99.
11 Rosen v. Comm'r, 62 T.C. 11 (1974), *aff'd without pub. op.*, 515 F.2d 507 (3d Cir. 1975); Owen v. Comm'r, T.C. Memo. 1987-375, *aff'd*, 881 F.2d 832 (9th Cir. 1989). See Smith v. Comm'r, 84 T.C. 889 (1985), *aff'd without pub. op*. 805 F.2d 1073 (D.C. Cir. 1986); Beaver v. Comm'r, T.C. Memo. 1980-429.
12 872 F.2d 519 (2d Cir. 1989), *rev'g*, 85 T.C. 824 (1985).
13 143 F.3d 487 (9th Cir. 1998), *rev'g*, T.C. Memo. 1996-191.
14 Seggerman Farms, Inc. v. Comm'r, T.C. Memo. 2001-99.
15 *Id.*
16 327 F.2d 788 (7th Cir. 1964), *aff'g*, 40 T.C. 273 (1963).
17 T.C. Memo. 2001-99.
18 Miscellaneous Trade and Technical Corrections Act of 1999, Pub. L. 106-36, Sec. 3001(e), 113 Stat. 127,184 (1999).
19 *Id.*
20 *Id.*, Sec. 3001(b), 113 Stat. 182 (1999).
21 T.C. Memo. 2001-99.
22 *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

ADDITIONAL CHILD TAX CREDIT. The debtor claimed an exemption for a portion of an income tax refund. The exemption was claimed under Idaho Code § 11-60394) for benefits received under federal, state or local public assistance legislation. The debtor claimed that a portion of the refund resulted from the additional child income tax credit allowed under I.R.C. § 24(d). The court applied a three part inquiry as to whether the tax credit was in the nature of public assistance: whether the credit had a public assistance purpose, whether the credit was refundable, and at what income level did the

**Agricultural Law Manual* (ALM).

credit phase out. The court held that the additional child credit had the public assistance purpose to help families with three or more children and was refundable. However, the court held that the credit was not eligible for the exemption because the credit was available to higher income families, thus demonstrating that the credit was not intended to serve as public assistance legislation. ***In re* Steinmetz, 261 B.R. 32 (Bankr. D. Idaho 2001)**.

CHAPTER 12-*ALM* § 13.03[8].*

LEGISLATION. The President on June 26, 2001 signed H.R. 1914 (Pub. L. No 107-8) which retroactively extends Chapter for four months, from June 1 until October 1, 2001.

PLAN. The debtors owed two secured claims on their farm, a first mortgage to a bank and a second mortgage to the FSA. The FSA mortgage was only partially secured by the farm. The debtors had signed-up their entire form for CRP and were eligible for nine more years of CRP payments. The debtors' plan provided for payment of the secured claims from nonfarm income and the CRP payments but listed the FSA claim as secured only by the farm. The FSA did not claim any right of setoff of the CRP payments but objected to the plan because it did not characterize the entire FSA claim as secured, in part by the farm and the remainder by the future CRP payments. The debtors also argued that the FSA had waived its setoff rights by not including them in it claim in the bankruptcy case. The court held that the plan could not be confirmed because the FSA right of setoff made the entire claim secured. The court also held that the right of setoff was not waived because the FSA objected to the plan. ***In re* Krause, 261 B.R. 218 (Bankr. 8th Cir. 2001)**.

The debtors had challenged a secured claim based upon a mortgage as unenforceable. While that issue was being appealed, the debtors obtained the consent of the creditor for the confirmation of the plan. The confirmation agreement provided that if the mortgage claim was upheld, the claim would be paid in full. The plan did not make any provision for post-petition interest on the mortgage claim. The plan also contained a provision that the bankruptcy estate property would not revest in the debtors upon confirmation of the plan. The mortgage claim was resolved in favor of the creditor several years after confirmation of the plan and the creditor sought post-petition interest on the claim. At the time the post-petition interest was sought, the estate had more than enough property to pay the claim and interest. There was uncertainty whether the excess estate property resulted from appreciation or the efforts of the trustee to maximize the property by selling the property in small lots. The debtors argued that post-petition interest was not allowed because the debtors were insolvent at the confirmation date. The court held that post-petition interest was allowed because (1) the debtors did not prove that they were insolvent on the confirmation date, (2) the confirmation agreement provided for payment "in full" of all secured claims, and (3) any post-petition appreciation of estate assets accrued to the estate because the property did not revest in the debtors upon confirmation, as provided in the confirmation agreement. **In re Ogle, 261 B.R. 22 (Bankr. D. Idaho 2001)**.

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. The taxpayer filed timely returns for 1989 through 1992 but did not pay the taxes when due. The returns improperly claimed deductions for residential mortgage interest and home office deductions because the residence was owned separately by the taxpayer's spouse. The spouse and taxpayer had their returns prepared by third parties based on the information provided by the taxpayer and spouse. The court held that the taxpayer did not willfully attempt to evade payment of tax and did not intend to file fraudulent tax returns, but merely made negligent mistakes in claiming the improper deductions. The court held that the taxes were dischargeable. ***In re* Frosch, 261 B.R. 181 (Bankr. W.D. Pa. 2001)**.

The debtor had filed a previous bankruptcy case in 1997 which included tax claims for 1995 and 1996. That case continued for over two years before being dismissed. The current case was filed in September 2000 and the debtor sought to have the 1995 and 1996 taxes declared dischargeable as due more than three years before the filing of the petition. The court followed the majority of cases which hold that the three year period of Section 507(a)(8)(A)(i) was tolled during the previous bankruptcy case. ***In re* Fiels, 260 B.R. 362 (Bankr. D. Md. 2001)**.

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. The plaintiffs were grain producers who had entered into hedge-to-arrive (HTA) contracts with the defendants, a corporation which was a guarantor futures commission merchant, and its wholly-owned subsidiary which was an introducing broker. The defendants marketed the HTA contracts through a local agent who presented the HTA contract concept at seminars and programs for the plaintiffs. The contracts were marketed as low risk and a method of establishing a floor price for grain prior to sale. The plaintiffs brought suit against the defendants as the principals for the local agent, alleging that the HTA contracts were illegal off-exchange futures contracts and that the marketing of the contracts violated federal racketeering laws (RICO) for wire and mail fraud. The defendant sought and obtained a dismissal of the case in the District Court for lack of standing and for failure to properly plead mail and wire fraud under RICO. The court held that the plaintiff sufficiently plead the agency relationship between the corporations and the local agent, the possible violations of the Commodity Exchange Act if the HTA contracts were proven to include the sale of off-exchange futures, and the acts which would violate the wire and mail fraud provisions of RICO. The court did not discuss or rule on the merits of any of these issues. **Abels v. Farmers Commodities Corp., No. 00-2045NI (8th Cir. July 3, 2001)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT. The plaintiffs were nonprofit environmental organizations. The defendant irrigation district applied aquatic herbicide to its irrigation canals to control weeds. The herbicide contained a chemical which caused a massive fish kill and the plaintiffs sued the defendant for violation of the Clean Water Act for application of a pollutant without a National Pollution Discharge Elimination permit. The lower court had held that the herbicide was a pollutant and that the canals were waters of the U.S. but held that no permit was required because the herbicide was fully regulated by the EPA under FIFRA. The appellate court affirmed the first two holdings, noting that the canals were covered as waters of the U.S. also because the canals drained into several natural creeks and streams. The appellate court reversed on the third holding because it held that FIFRA did not regulate the application of herbicides into waters of the U.S. The court noted that the FIFRA and CWA had different purposes and jurisdictions; therefore, a regulated herbicide could be a pollutant under the CWA. **Headwaters, Inc. v. Talent Irrigation District, 243 F.3d 526 (9th Cir. 2001)**.

FEDERAL AGRICULTURAL PROGRAMS

LEGISLATION. Legislation has been introduced in the U.S. House of Representatives to dedicate revenues from recent tobacco tax increases for use in buying out tobacco quotas. **H.R. 2334**.

ADVERTISING ASSESSMENTS. The U.S. Supreme Court has affirmed the following decision. The plaintiff was a mushroom grower and was assessed funds for the advertising of mushrooms as required under the Mushroom Promotion, Research and Consumer Information Act, 7 U.S.C. § 6101 *et seq*. The plaintiff argued that the assessment violated the First Amendment of the U.S. Constitution in that it required the plaintiff to participate in the advertisements which the plaintiff saw as against the plaintiff's interest. The court interpreted *Glickman v. Wileman Bros. & Elliott, Inc., 521 U.S. 457 (1997)* as upholding the constitutionality of advertising assessments only where the marketing within an industry was completely regulated (within the check-off statute) as was the fruit tree industry in *Wileman*. Because the marketing of the mushroom industry was not completely regulated, the assessments for compelled commercial speech violated the plaintiff's First Amendment right to not participate in the commercial speech in the advertisements. The *Digest* will be publishing an article by Neil Harl on this case. **United Foods, Inc. v. United States, No. 00-276 (S. Ct. June 25, 2001), *aff'g*, 197 F.3d 221 (6th Cir. 1999)**.

PERISHABLE AGRICULTURAL COMMODITES. The debtor had entered into a contract to sell tomatoes raised by the debtor. The buyer was a produce broker who agreed to arrange for the harvest, packing and sale of the tomatoes. The contract provided that the broker would receive a commission of 10 percent for the services and that the costs of harvest and packing would be deducted from the sale proceeds to be returned to the debtor. The broker also received a commission from the buyers of the tomatoes which was paid as a percentage of the purchase price. When other creditors sought to attach the proceeds from the sale, the broker placed the funds with the court. However, the broker reduced the proceeds by the 10 percent commission and the costs of harvest and packing. The trustee sought to include the commission fee in the amount deposited with the court because the commission represented a double charge in violation of 7 U.S.C. § 499e. The court held that the commission was not a double charge because the debtor did not pay the fee charged to the buyers, the debtor agreed to the commission, and the broker provided adequate services to justify the commission. ***In re* Borek, 260 B.R. 886 (Bankr. S.D. Fla. 2001)**.

FEDERAL ESTATE AND GIFT TAX

No items

FEDERAL INCOME TAXATION

LEGISLATION. Legislation has been introduced in the U.S. House of Representatives to (1) establish a deduction for contributions to a Farm, Fishing, and Ranch Risk Management Account (FFARRM account); (2) exempt income tax averaging for farmers from the alternative minimum tax; (3) provide that the payment of dividends on the stock of a cooperative would not reduce net earnings (4) increase the small producer ethanol credit; (5) include in the definition of the term "marketing the products of members or other producers" the feeding the products of members or other producers to cattle, hogs, fish, chickens, or other animals and selling the resulting animals or animal products; and (6) provide for a charitable deduction for gifts of food inventory. **H.R. 2347**. Legislation has also been introduced which would exclude from the preproductive expenses rules the costs of replanting edible crops destroyed by casualty. **H.R. 2354**.

ACCOUNTING METHOD. In the early 1990s, the taxpayer built and placed into service several gas station convenience stores and initially claimed depreciation deductions under the MACRS for the properties as nonresidential 31.5 or 39 year recovery property. In 1996 the taxpayer filed amended returns which reclassified the property as 15-year property, consistent with an Industry Specialization Program Coordinated Paper issued by the IRS. In 1996 and 1997 the taxpayer's tax returns continued to claim depreciation deductions using the 15-year classification. The IRS argued that the change of depreciation method was a change in accounting method which required IRS approval. There was no disagreement that the properties were not properly 15-year recovery property. The court held that the change in the depreciation calculation was not a change in accounting method which required IRS consent. **Brookshire Brothers Holding, Inc. v. Comm'r, T.C. Memo. 2001-150**.

BUSINESS EXPENSES. The taxpayers operated a wholesale/retail business about six miles from their rural residence. The taxpayers maintained an office for the business at their residence and maintained several cattle at their residence. The taxpayers claimed travel expenses for use of automobiles to travel from their residence to their business, arguing that the travel was between two businesses. The court held that the travel expenses were not eligible for a business deduction because the primary purpose of the travel from the business to the residence was personal. The court also disallowed the travel deduction because the taxpayers did not keep complete records of the travel. The taxpayer restored a pond on their residence which had become stagnated after a winter storm caused several trees to fall into the pond. The court held that no casualty deduction was allowed for the expense of repairing the pond because the pond became stagnated over several months from several causes. The appellate court affirmed in a decision designated as not for publication. **Barmes v. Comm'r, 2001-2 U.S. Tax Cas. (CCH) ¶ 50,487 (7th Cir. 2001),** ***aff'g*****, T.C. Memo. 2000-254**.

The taxpayers, husband and wife, jointly owned a Christmas tree farm. The taxpayers claimed deductions for health insurance for the wife paid for by the business. The taxpayers argued that the wife was an employee of the husband and presented an employment agreement as proof of the employment relationship. The court disregarded the employment contract because the wife was paid more than the contract allowed, the wife worked less hours than the contract required and the wife's work was more consistent with a co-owner relationship than an employment relationship. Therefore, the court held that the health insurance costs were not allowed as a business deduction. **Poyda v. Comm'r, T.C. Summary Op. 2001-91**.

COURT AWARDS AND SETTLEMENTS-ALM § 4.02[14]. The taxpayer was an employee of a large corporation and was offered the opportunity for early retirement in exchange for cash benefits. The taxpayer agreed to the early retirement and made one of several elections for the timing and amount of the severance payments. The taxpayer signed a general release of liability of the employer for a large number of possible actions against the employer. The release was used for all early retirees who terminated employment under the same program. The taxpayer had not made any tort claims against the employer. The court held that the money received by the taxpayer was included in income because (1) the release was required for all early termination employees, (2) the amount of money paid was dependent upon the taxpayer's salary and length of employment with the company and not any claim made by the taxpayer, and (3) the payment was in the nature of severance pay and not settlement of a claim. The appellate court affirmed in a decision designated as not for publication. **Metelski v. Comm'r, 2001-2 U.S. Tax Cas. (CCH) ¶ 50,482 (3d Cir. 2001),** ***aff'g*****, T.C. Memo. 2000-95**.

The taxpayer was terminated from employment with the Federal Aviation Administration (FAA) and sought compensation under the Federal Employees' Compensation Act (FECA) for emotional injury resulting from harassment and racial discrimination during the employment. The taxpayer did receive disability payments under the Federal Employees' Retirement System (FERS). The taxpayer excluded the payments from income, under I.R.C. § 104, arguing that the payments should have been made under FECA and not FERS; therefore, the payments were excludible from income. The court held that, although the taxpayer may have suffered a disability resulting from employment and covered by FECA, the payments were actually made under FERS and were included in gross income. **Norris v. Comm'r, T.C. Memo. 2001-152**.

DEPRECIATION. The taxpayer was a partner in a partnership which purchased a horse breeding farm from a corporation principally owned by the taxpayer. The partnership had claimed depreciation deductions based on a purchase price of the farm of $1.5 million, although the partnership paid the corporation only $350,000 in cash with no additional indebtedness for the purchase price. The taxpayer attempted to demonstrate that the buildings cost more than $1 million to construct but the court held that (1) the taxpayer failed to prove the cost of constructing the buildings and (2) the cost of constructing the buildings was irrelevant because the partnership's basis was dependent solely upon the purchase price paid by the partnership. The taxpayer also argued that the corporation received an interest in the partnership as part of the sales price, but the court rejected this claim because the sales contract made no mention of such consideration for the farm. Thus, the partnership depreciation deductions were limited to the portion of the $350,000 purchase price allocable to the depreciable property. **Vajda v. Comm'r, T.C. Memo. 2001-159**.

The taxpayers were denied depreciation deductions for two automobiles which the taxpayers claimed were used in their businesses. The court denied the deductions because the taxpayers failed to provide any record of the business use of the automobiles. **Barmes v. Comm'r, T.C. Memo. 2001-155**.

DISASTER PAYMENTS. On June 17, 2001, the President determined that certain areas in Florida were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of tropical storm Allison from June 11-15, 2001. **FEMA-1381-DR**. On June 21, 2001, the President determined that certain areas in Mississippi were eligible for assistance under the Act as a result of tropical storm Allison from June 8-13, 2001. **FEMA-1382-DR**. Accordingly, a taxpayer who sustained a loss attributable to the disasters may deduct the loss on his or her 2000 federal income tax return.

HEALTH AND ACCIDENT PLAN PAYMENTS. The court held that payments received under the Minnesota State Retirement System for disabilities were included in income because the payments would continue only while the taxpayer was unemployed. **Goodchild v. Comm'r, T.C. Summary Op. 2001-102**.

HOBBY LOSSES. The taxpayer owned an ocean yacht which the taxpayer used for personal and charter fishing. There was some evidence that the boat was also used to entertain employees of corporations owned by the taxpayer but the taxpayer did not maintain accurate and complete records of the boat's use. The court held that the losses from the boat could not be deducted as business expenses because the taxpayer had no realistic expectation of ever making a profit from the boat. The court cited a magazine article in which the taxpayer stated that no profit could be made from sport fishing. **O'Connell v. Comm'r, T.C. Memo. 2001-158**.

INCOME. The taxpayer was an attorney and had revenues which represented fees paid for work already performed and retainer fees for work to be performed in the future. The taxpayer did not keep accurate records of these payments and failed to file returns for two tax years. The IRS reconstructed the taxpayer's income for these two years by including in income all deposits to the taxpayer's personal and business accounts from the trust accounts. Because the taxpayer lacked records to controvert the IRS determinations, the court upheld the IRS calculation of the taxpayer's income for the two tax years. **Kaufman v. Comm'r, T.C. Memo. 2001-161**.

LEVY. The taxpayer was assessed for tax deficiencies and the IRS sought to levy against the proceeds of insurance on a farm destroyed by fire which was owned by the taxpayer's former wife. The evidence demonstrated that the taxpayer had transferred the property to the former spouse and divorced the spouse in order to hide assets from the IRS. The evidence also demonstrated that the taxpayer continued to use the farm and other assets transferred as the taxpayer's own. The court held that the insurance proceeds were subject to the levy. **Scoville v. United States, 2001-1 U.S. Tax Cas. (CCH) ¶ 50,442 (8th Cir. 2001), *aff'g*, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,163 (D. Mo. 2000)**.

LOSSES. The taxpayer had owned two adjacent lots which were not used in the taxpayer's trade or business. In 1993 the taxpayer sold the lots to a third party in exchange for indebtedness owed to the third party. The taxpayer retained an option to repurchase the lots and gave the buyer a promissory note for the option. No payments were made on the option promissory note and in 1996, the taxpayer executed a relinquishment of the option. The taxpayer claimed a loss in 1996 for the sale of the lots for less than the income tax basis. The court held that no sale or exchange occurred in 1996; therefore, no loss deduction could be claimed in 1996. **Hale v. Comm'r, T.C. Summary Op. 2001-99**.

MARKET SEGMENT SPECIALIZATION GUIDE. The IRS posted a revised version of the Shareholder Loans Market Segment Specialization Program Audit Technique Guide (6-01) on its web site, http://www.irs.gov. The document addresses issues regarding loans to shareholders. It examines bona fide debt v. non bona fide debt, the mechanics of bona fide debt, below-market loans, demand loans, the de minimis exception, computations and interest issues on market rate loans. **IRPO ¶ 217,925**.

PENSION PLANS. The taxpayer was a family farm corporation which adopted an ESOP defined contribution plan. The plan had the same person as the trustee and only participant, the president of the taxpayer. Instead of paying the president wages for managing the farm, the taxpayer paid the president as an independent contractor, with the president reporting the income on Schedule C as a sole proprietor. The taxpayer claimed no deduction for wages and deducted the payments to the president as management fees. The IRS disqualified the ESOP because the taxpayer paid no compensation to employees. The taxpayer argued that the management fees paid to the president were sufficient to qualify the plan. The court held that the president was not employed by the taxpayer but was a sole proprietor, essentially self-employed. The court held that the management fees did not qualify as compensation to the president; therefore, the taxpayer could not claim any deductions for contributions to the ESOP, which was limited to 25 percent of the participant's compensation. There was no discussion of whether the president would be considered an employee under other aspects of income tax law. The appellate court affirmed in a decision designated as not for publication. **Van Roekel Farms, Inc. v. Comm'r, 2001-2 U.S. Tax Cas. (CCH) ¶ 50,490 (8th Cir. 2001), *aff'g*, T.C. Memo. 2000-171**.

The IRS has issued guidance regarding amending qualified plans as a result of the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16. **Notice 2001-42, I.R.B. 2001-__**.

For plans beginning in June 2001, the weighted average is 5.82 percent with the permissible range of 5.24 to 6.11 percent (90 to 106 percent permissible range) and 5.24 to 6.40 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 2001-39, I.R.B. 2001-__**.

The IRS has released three Industry Specialization Program Settlement Guidelines addressing hybrid arrangements of cafeteria and qualified retirement plans, the deductibility of health insurance for self-employed individuals and the retroactive adoption of accident and health plans. **IRPO ¶¶ 180,048, 180,068, 180,080**.

PENALTIES. The taxpayers had invested in jojoba partnerships which had been held to be without economic substance. The taxpayer's deductions involving the partnership interests were disallowed. The issue in this case was whether the taxpayers were subject to negligence and understatement of tax penalties. The taxpayer did not fully read the partnership agreements and consulted only with a friend who was a CPA. The court held that taxpayers were subject to the negligence and understatement of tax penalties because the amount of investigation by the taxpayer was unreasonable, give the substantial tax deductions taken. **Kessel v. Comm'r, T.C. Summary Op. 2001-96; Nilsen v. Comm'r, T.C. Memo. 2001-163**.

TRUSTS. The taxpayers transferred their two sole proprietorship businesses to a trust. The taxpayers had all income and expenses run through the trust and filed personal income tax returns without reporting that income. The court held that the trust was a sham and that all income and expenses were treated as personal to the taxpayers. **Barmes v. Comm'r, T.C. Memo. 2001-155**.

INSURANCE

COVERAGE. The plaintiff had purchased property insurance to cover soybeans stored in bins located on the plaintiff's farm. The policy excluded losses from mold but covered losses from "ensuing fire" from mold. Some of the stored soybeans were charred and blackened. The storage workers found clumps of beans which were too hot to handle and which glowed. The heat was caused by mold growth which created sufficient heat to "burn" the beans. No flames were seen but the beans smoked around the hot spots. The court held that the heat damage from mold was covered under the insurance policy which covered damage from "ensuing fire" because the plaintiff proved the existence of smoke, heat and orange light in the beans. In addition, the court held that the damage was covered under the policy because the damage was caused primarily by the heat, a covered damage, and not the mold. **Bruce Oakley, Inc. v. Farmland Mutual, 245 F.3d 1027 (8th Cir. 2001)**.

LANDLORD AND TENANT

TERMINATION. The defendants had entered into a 99-year lease of a farm. The lease was renewable forever by the defendant's family. The lease provided, however, that it could be terminated "for need." The plaintiff was the guardian of the lessor and served a notice of termination of the lease, stating that the lease was terminated because the lessor was in bad health and needed to sell the property in order to qualify for medical benefits. The defendants claimed that the lessor had conveyed the farm in fee to them in a letter which indicated that the lessor intended the defendants to have the farm "till the end of this Age." The court held that the termination was valid in that it was based on the need of the lessor. In addition, the court held that the lessor's letter was ineffective to pass title to the defendants because the letter contained no words of transfer and the defendants gave no consideration for the letter. **Earl v. Beager, 20 P.3d 788 (Mont. 2001)**.

PROPERTY

FENCE. The respondent filed a petition for a fence viewing because the respondent wanted to raise cervidae (animals of the deer family) on the respondent's property. The respondent planned to build a 96 inch barbed wire fence but agreed that the neighbors needed to pay an assessment based upon a shorter fence. The neighbors offered to build their own fences but only the shorter version. The state law required the taller fence for cervidae farms. The viewers ordered the neighbors to pay a portion of the fence costs based upon the cost of a shorter fence, even though the respondent planned to build a taller fence. The neighbors challenged the order as an unconstitutional taking. The court noted that the neighbors failed to provide any evidence of loss of property use or value from the fence and noted that the neighbors would receive the benefit of protection from trespassing cervidae. The neighbors also argued that they should have been allowed to construct their own fences but the court held that the fences were inadequate for a cervidae farm; therefore, the fence viewer's order was upheld. ***In re* Petition of Bailey, 626 N.W.2d 190 (Minn. Ct. App. 2001)**.

STATE TAXATION

AGRICULTURAL USE. The plaintiff owned 50 acres of pasture which was not used for agriculture but left vacant. The land was not fenced and cattle owned by a tenant of the neighboring land often trespassed on the pasture for grazing. The plaintiff did not know about the trespassing in 1996, the tax year in issue, but when the trespass was discovered in 1999, the plaintiff entered into a pasture lease with the neighboring tenant. The plaintiff sought agricultural use valuation for the property for 1996 based upon the trespass grazing of the neighbor tenant. The court held that the trespass grazing of the land was not sufficient to support an agricultural use of the land because the plaintiff did not gain any monetary profit from the activity. **Besch v. Jefferson County Bd. Of Comm'rs, 20 P.3d 1195 (Colo. Ct. App. 2000)**.

VALUATION. The taxpayer appealed the 50 percent increase in assessed value of the taxpayer's farm. The assessment was based primarily on the location of the entire farm within the county and the taxpayer argued that the valuation was too high because the farm had several areas of lower quality soil. The taxpayer based the value on comparable sales of property with similar soils but the defendant board of assessment rejected the taxpayer's evidence. The court held that the taxpayer had presented sufficient evidence of valuation to rebut the presumption that the assessment was correct. The court also held that the assessment was in error because it was not based on sales of comparable properties with comparable soils. The court held that the valuation of property based solely on the location within the county was arbitrary because the assessment board provided no evidence to support that valuation method. The court also cited *Bartlett v. Davis County Bd. Of Equal., 613 N.W.2d 810 (2000)* as requiring that farm land valuation be based upon soil classification. **Schmidt v. Thayer County Bd. Of Equal., 624 N.W.2d 63 (Neb. Ct. App. 2001)**.

WATER RIGHTS

ABANDONMENT. The previous owner of the plaintiff's property had irrigated the property from a creek under a water right. The previous owner had defaulted on a federal loan and the farm was owned by the FmHA for several years. The FmHA leased the farm to several third parties before selling it to the plaintiff. The lessees did not irrigate the property during four years and one lessee attempted to irrigate the property but the water was diverted by the watermaster, the defendant, in order to irrigate the defendant's property. The lessee was able to irrigate only 25 acres in that year. An adjudication of water rights was commenced and the special master ruled that the water rights were abandoned for nonuse over five years, except for the 25 acres. The plaintiff argued that the five year period should have been tolled during the period that the watermaster diverted the water, preventing irrigation. The court held that the diversion did not toll the five year period because the land was not ready to support irrigation during that year. **McCray v. Rosenkrance, 20 P.3d 693 (Idaho 2001)**.

CITATION UPDATES

Estate of Cherry v. United States, 133 F. Supp.2d 949 (W.D. Ky. 2001) (income in respect of decedent) see p. 36 *supra*.

Grojean v. Comm'r, 248 F.3d 572 (7th Cir. 2001), aff'g, T.C. Memo. 1999-425 (basis in S corporation) see p. 79 *supra*.

Thom v. United States, 134 F. Supp.2d 1093 (D. Neb. 2001) (installment reporting) see p. 70 *supra*.

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